

R&T – I

***Audit Services Procurement System***

Texas Council for Developmental Disabilities

***Audit Services Procurement System***

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# ***Audit Services Procurement System***

## **Introduction**

Procurement of a quality audit is apparently easier said than done giving consideration to a 1989 General Accounting Office report that identified 34 percent of CPA audits it reviewed as substandard. A study conducted by the GAO disclosed that entities with substandard procurement systems stood a 46 percent chance of receiving a substandard audit. Those entities that followed systematic audit procurement practices experienced a significantly lower rate of substandard audits (17%).

Entities receiving federal assistance should follow guidelines for procurement of audit services in Appendix A (See page 4-32 of this document). These guidelines allow for four possible methods of procurement based on the circumstances surrounding any given procurement. However, competitive negotiation procedures seem to be best suited for the procurement of audit services. Competitive negotiation is therefore the preferred method for obtaining audit services. It is flexible enough to consider price but permits the entity to make informed choices regarding the quality of services to be provided. Competitive negotiation allows an entity to trade off features of experience, quality, qualifications, and value and to take advantage of unique talents and proposals that might be offered and tailored precisely to the entity's needs.

## **The Procurement Process**

There are basically six steps in the procurement process. They are:

1. Procurement planning
2. Identification of potential bidders
3. Solicitation of bidders
4. Technical evaluation of proposals
5. Documentation of audit engagement
6. Monitoring of audit work

## **Procurement Planning**

The following considerations should be made during the planning process:

### **Define the entity to be audited and the scope of that audit.**

In order for an auditor to properly assess the amount of work required for a given engagement the boundaries of that work such as related organizations and specific projects to include must be well defined.

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### **Determine the specific audit requirements.**

Federal and state assistance generally carries a specific audit requirement. Reference to those grant documents should be made to determine any special or non-standard reports or assurances necessary to comply with. Particular attention should be paid to the requirements of OMB Circular A-133.

**Identify the attributes necessary in an auditor.**

Budget considerations notwithstanding, technical proficiency in auditing (particularly governmental auditing) is critical to ensuring audit quality and compliance with related audit requirements.

**Review legal requirements.**

Organizations expending federal or state funds for audit services must procure these services in accordance with certain guidelines (see Appendix A, page 4-32, Sec. 3).

**Establish a work schedule or timeline.**

Except for those audits performed by the Texas State Auditor, audits generally are due within 30 days after issuance and not longer than nine months after the end of the related fiscal year end. A work schedule that allows for timely completion in order to conform to these guidelines is important.

**Identification Of Potential Auditors**

Fostering competition among service providers is one of the most effective means for obtaining a 'reasonable' audit cost. While it is not to be considered the primary consideration given to auditor selection, it is a major consideration given the tight economic times we live in. However, it is urged that quality take precedence over cost.

Means for obtaining information about potential firms include:

1. Previous auditors interviewed by other organizations
2. Newspapers
3. Referrals
4. Yellow Pages
5. Direct Mail

**Solicitation Of Audit Services**

Audit services solicitation is the means by which audit requirements and auditor qualifications are communicated to the population of prospective auditors. A Request For Proposal (RFP) should be prepared to include the following:

- name and address of organization.
- entity to be audited.
- scope of services to be provided.
- specific reports, schedules, etc., to be delivered.
- period to be audited.
- period of auditor engagement (see below).
- contact person at your organization.

- format of proposal.
- address proposal should be delivered to.
- date proposal is due.
- number of copies to submit.
- evaluation criteria used and relative importance of each factor.
- payment terms.
- any other important points, including the consequences if due dates are missed or work does not meet audit standards.
- explanation of what your organization does.
- Identify appropriate auditing standards and applicability of the Single Audit Act and OMB A-133
- inform prospective auditors that subrecipient audits are required.
- notify prospective auditors that workpapers must be retained for five years and made available to the entity as well as governmental auditors if requested.
- specific audit guide or program to be followed.
- list of restrictions, such as copy service or workspace.
- describe expected audit products, the required format of the audit report, and the format of any required progress reports.
- explain any assistance that your organization will offer, such as staff support to assist the auditor (which could materially reduce your audit costs).
- outline the expected schedule of work (completing fieldwork, issuing reports, etc.).
- exit conference requirements.

Minimum audit requirements under applicable laws such as the Single Audit Act.

- dates records would be ready for audit.
- dates for completing interim phases, such as fieldwork completion and draft report preparation.
- date of contract award.
- entity's right to reject proposal.
- provision for Equal Employment Opportunity.
- provision for termination of contract (e.g., nonperformance, substandard work, untimeliness, etc.).
- provision for administrative and/or legal remedies for contract violations.

The RFP should seek to obtain certain information from prospective auditors such as current status of CPA licensure.

- how auditor would conduct the audit (including subsequent years).
- auditor's qualifications, those of their local office, if applicable, and those of the proposed audit staff,
- auditor's prior government auditing experience.
- auditor's policies on notification of changes in key personnel,
- amount of staff continuing professional education in governmental accounting and auditing during last two years.
- whether auditor is independent, as defined by applicable auditing standards,
- whether auditor has received a positive peer review within the last three years,
- whether auditor has been object of any disciplinary action during the past three years, and
- fee quotation and expected payment terms.

## **Multiyear Contracts**

Because multiyear contracts allow the auditor to spread the cost of the learning curve over a period of years and reap the benefits of repetition efficiencies, the annual fee could be less than a proposal prepared on an annual basis. Because quality is a major concern, this seems to be the best way of ensuring cost effectiveness and audit quality while maintaining periodic competitive influences.

## **Technical Evaluation Of Proposals**

A systematic framework for selecting an auditor on the basis of technical qualifications is the surest way of obtaining quality audit services. It also documents that the auditor was selected fairly.

The first step of the technical evaluation process is to determine if all requirements of the RFP have been satisfied by the auditor's proposal. A checklist of all RFP requirements would prove useful for this determination. The second step of the technical evaluation process should be to establish that the prospective auditor possesses certain minimum standards. Minimum standards should include

- appropriate state licensing requirements (CPA),
- conformance with applicable independence standard, and
- a record of responsible work.

Additionally, to be considered qualified, an auditor should possess the following characteristics:

- experience in governmental auditing (ask for references).
- adequate levels of continuing professional education (10-20 hours annually) for all involved staff. AICPA standards require 120 hours for every 3-year period of CPE with a minimum of 20 hours completed per year. Additionally, firms that perform audits under

the *Government Auditing Standards* must complete 80 hours every 2 years, and at least 24 of these must be in subjects directly related to the government environment, government auditing, or other specific or unique environments (i.e., audits of non-profits under OMB Circular A-133).

- in compliance with AICPA rules regarding peer review.
- employ sufficient personnel to allow for timely work completion.

The proposal should indicate that the auditor has a complete understanding of the requirements of the engagement. The proposed audit approach should show clearly how all audit requirements will be met. Auditor technical qualifications should stand on their own merit while auditors with minimal previous experience should have references checked thoroughly.

The auditor selection process requires many subjective judgments. Each firm's technical criteria should be evaluated before factoring in cost or price to arrive at a final selection.

## **Documentation Of Audit Engagement**

A written agreement assures a better understanding of the responsibilities of both parties and provides for specific accountability.

The written agreement should specify the following:

- audit scope, objective and purpose,
- completion timelines,
- audit cost,
- report format,
- type and timing of support to be provided to the auditor by the entity,
- professional auditing standards to be followed in performing the audit,
- that the entity may, by written notice, make changes in or additions to work,
- that the audit shall be conducted in accordance with the provisions in the RFP, and
- a definition of a substandard audit and sanctions in case of one.

Entities, which obtain a written agreement, are in a better position to take recourse against the audit firm in the event of poor quality work. Recourse measures include such things as creating adverse publicity for the firm through negative references, referring auditors to the appropriate state licensing boards, requiring the auditor to properly complete the engagement and/or withholding payment.

## **Monitoring Of Audit Work**

Monitoring the audit work is an effective way to ensure that your organization receives a quality audit. Monitoring can be especially beneficial during the first year of a new auditor's contract and during the audit of a particular unit or segment(s) of an organization that is unique or complex.

Monitoring by requiring periodic progress reports as well as by holding regular meetings to discuss issues that need to be resolved is particularly efficient.

By monitoring the progress of an audit, problems that arise can be dealt with timely and at a time when the most resources are available to assist in resolution.

Methods Used to Monitor Auditor's Work:

- Informal discussions with CPA
- Conferences with CPA
- Review CPA's adjusted books
- Review CPA's corrective actions



- Tests of CPA's work
- Review CPA's workpapers

## Conclusions and Recommendations

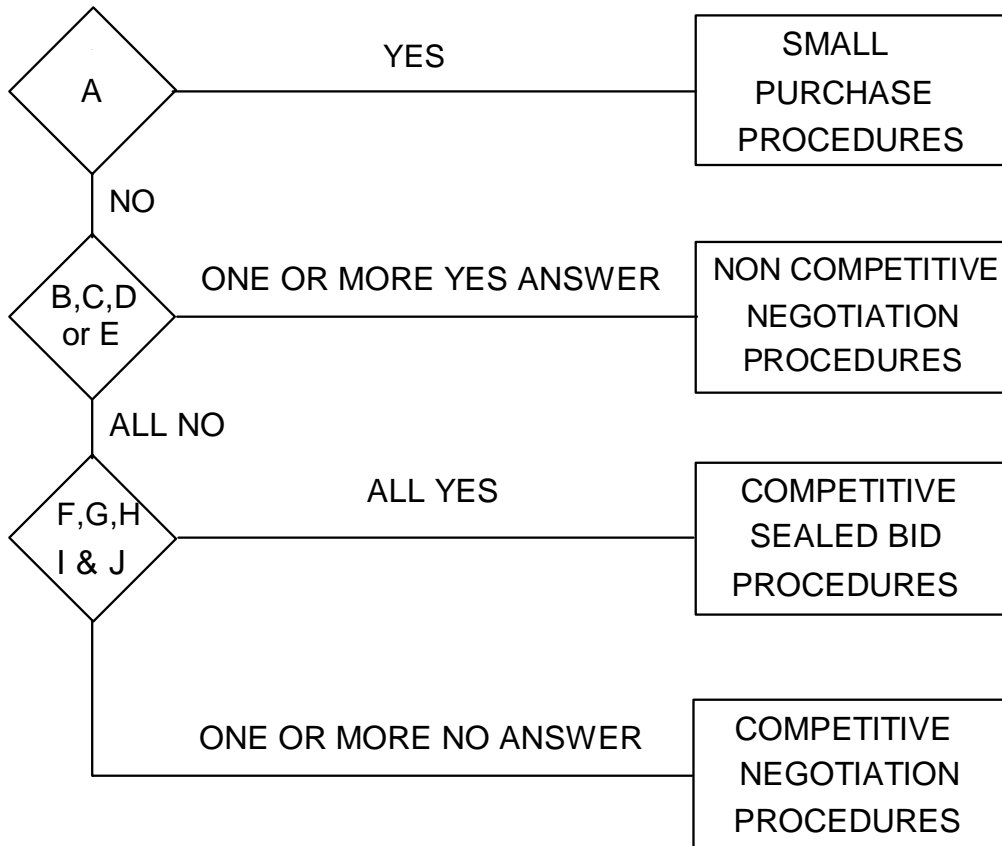
The following recommendations of the GAO are considered worthy of mention:

1. Ensure that at least two audit firms are considered when selecting a qualified auditor.
2. Provide multiyear contracts when possible, preferably for 3-5 years.
3. Ensure that the solicitation, whether it is a request for proposal, invitation for bid, or other method is comprehensive and that all requirements for the audit engagement are communicated to interested audit firms.
4. Technical factors in selecting a qualified audit firm should include the audit firm's past governmental or industry experience, the firm's technical approach to performing the audit, and/or the qualifications of individual staff assigned to the engagement.
5. Ensure that a technically qualified firm performs the audit engagement at a price competitive with that of similarly qualified firms. Cost should be one of the factors in selecting a CPA, but should not override a firm's technical qualifications.
6. Prepare a written agreement signed by both parties that stipulates all requirements of the engagement. For example, the firm may have to deliver the report by a specified date, and the entity may have to have its financial records in auditable condition. A complete statement of work which specifies the terms and scope of the engagement, the product or "deliverables," the engagement fee, and time and legal requirements should be included.
7. Ensure that some monitoring techniques are employed so that the entity obtains the services being paid for or are in a position to take recourse if the audit is substandard.

## Appendix A

### Method Of Procurement Decision Model

Service/Product  
Needed



- A. Is anticipated total cost of the goods or services less than or equal to \$25,000?
- B. Is the product or service available from only one service?
- C. Is there a public exigency or emergency, where the urgency for goods or services will not permit a delay incident to competitive solicitation?
- D. Has the Federal grantor agency authorized non-competitive negotiation in this instance?
- E. After solicitation of a number of sources, has competition been determined unavailable?
- F. Is a complete, adequate and realistic specification or purchase description available?
- G. Are two or more responsible suppliers willing to compete effectively for the business?
- H. Does the procurement lend itself to a firm-fixed price contract?
- I. Can the selection between bidders be appropriately made principally on the basis of price?
- J. Is the organization something other than a state agency, political subdivision, county, municipality, district, authority or publicly owned utility?

## Appendix B

### Methods Of Procurement

#### **Small Purchase Procedures**

1. Once a need for procurement of goods or services has been identified, a procurement conference should be held between the Director and Project Manager to identify the following:
  - a) technical requirements for the material, product or service to be procured, setting forth those minimum essential characteristics and standards to which it must conform if it is to satisfy its intended use.
  - b) potential sources to be solicited.
  - c) preliminary estimate of total cost.
2. The results of the procurement conference shall be documented in a memo to the files.
3. The potential suppliers identified above should be contacted and solicited for a written proposal(s) by providing the supplier with a written description of pertinent specifications.
4. The proposal(s) should be reviewed upon receipt by the procurement conferees. They should base their choice on demonstrated competence, knowledge and qualifications, and on the reasonableness of the proposed fee. If the conferees have no sound basis for judging the reasonableness of a proposed fee when only one proposal was solicited, they must obtain two other fee proposals, if possible. If, based on past experience, the proposed fee(s) seems high then renegotiations with any or all bidders should be attempted.
5. If a proposal is accepted it should be attached to the contract and all parties should receive signed copies. If all proposals are rejected and renegotiations appear futile, new solicitations of other potential suppliers should be made.

## **Non-Competitive Negotiation Procedures**

1. A memo to the files should be prepared detailing the reasons for the use of non-competitive negotiation.
2. A written request for proposal should be prepared detailing the exact specification of the service or goods to be provided.
3. Once a proposal is received, it should be analyzed by the procurement conferees, as defined in "Small Purchase Procedures," to determine if all specifications have been met. Additionally, any possible areas where costs might be reduced should be identified and renegotiated with the supplier for possible reduction.
4. Once an agreement is reached it should be attached to the contract and all parties should receive signed copies.

## **Competitive Sealed Bid Procedures**

1. A procurement conference shall be held between the Director and Project Manager to draft the invitation for bids. The invitation shall include the time and place for making bids and a clear definition of the items or services needed, including specifications and pertinent attachments.
2. Requests for proposals can be solicited from a number of known suppliers but must be advertised publicly in newspapers or the Texas Register.
3. Bids shall be solicited from an adequate number of known suppliers at least 15 days prior to the date set for opening of bids.
4. All bids shall be opened publicly at the time and place stated in the invitation for bids.
5. A firm fixed price contract award shall be made by written notice to that responsible bidder whose bid, conforming to the invitation for bids, is lowest. Where specified in the bidding documents, factors such as discounts, transportation costs and life cycle costs shall be considered in determining which bid is lowest. Payment discounts may only be used to determine low bid when prior experience of the organization indicates that such discounts are generally taken.
6. Any or all bids may be rejected when there are sound documented business reasons in the best interest of TCDD.
7. The accepted bid shall be attached to the contract and all parties shall receive signed copies.
8. The Professional Services Procurement Act prohibits the use of competitive bid procedures for procuring professional services by any state agency, political subdivision, county, municipality, district, authority, or publicly owned utility.

## **Competitive Negotiation Procedures**

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2. Requests for proposals can be solicited from a number of known suppliers but must be advertised publicly in newspapers or the Texas Register.
3. Proposals shall be solicited from an adequate number of known suppliers at least 15 days prior to the date set for opening bids.
4. Once proposals are received, negotiations should be conducted with more than one of the sources submitting offers.
5. The procurement conferees shall use sound business judgment in deciding which audit firm provides the most benefit to the Program, price and other factors considered.
6. Unsuccessful firms shall be notified promptly.
7. Either a fixed-price, cost-reimbursement or hourly type contract may be awarded, as appropriate.
8. Competitive negotiation may be used if conditions are not appropriate for the use of formal advertising.
9. The successful proposal should be attached to the contract and all parties should receive signed copies.